2007-05225/

THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE DECEMBER 2004

OVERVIEW

- In the third quarter of 2004 real gross domestic product (GDP) grew a solid 3.2%, following a 3.9% increase in the second quarter.
- Final domestic demand growth rose to 3.3% in the third quarter from 2.1% in the second. Stronger growth in consumer spending and business investment in machinery and equipment led the way. Business inventory investment surged $16.9 billion, up sharply from $2.3 billion in the second quarter.
- Part of the increased demand was met through a 13.0% jump in real imports. Real exports fell 2.0% after an 18.0% surge in the second quarter.
- The current account registered its 21st consecutive quarterly surplus despite a drop of $7.2 billion to $37.6 billion or 2.9% of nominal GDP.
- The Canadian economy created nearly 195,000 net new jobs in the first 11 months of 2004. The unemployment rate increased to 7.3% in November from 7.1% in September and October.

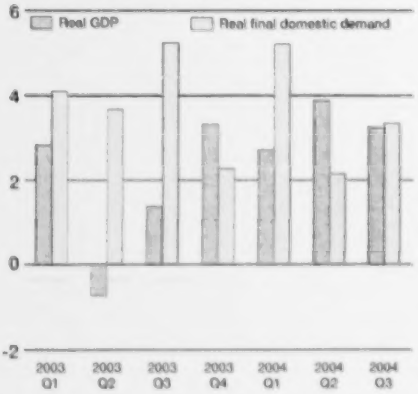
Real GDP growth at 3.2%

Real GDP rose 3.2% in the third quarter following a 3.9% gain in the second quarter. Domestic demand grew 3.3%, up from 2.1% in the previous quarter (Chart 1).

Consumer spending growth rises

Real consumer expenditure grew 3.0% in the third quarter, up from 2.1% in the second. Spending growth was strong for durables—mainly for furniture and appliances, given a strong housing market—and for semi-durables such as clothing and footwear. Services spending saw slightly lower growth than in the second quarter.

Chart 1
Growth in real GDP and real final domestic demand
per cent (annual rate)



Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, December 7, 2004.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	2002	2003	2004:Q1	2004:Q2	2004:Q3		Most recent
Real gross domestic product	3.4	2.0	2.7	3.9	3.2		–
Final domestic demand	3.1	3.6	5.2	2.1	3.3		–
Government expenditure							–
Goods and services	2.8	3.8	2.8	1.2	4.0		–
Gross fixed capital	9.1	6.8	5.3	-5.8	-2.4		–
Consumer expenditure	3.4	3.1	6.0	2.1	3.0		–
Residential investment	14.5	7.5	9.0	6.3	3.3		–
Business fixed investment	-4.0	3.2	3.5	3.7	5.2		–
Non-residential construction	-8.3	1.0	-3.5	0.9	0.6		–
Machinery and equipment	-1.2	4.5	8.2	5.5	8.2		–
Business inventory investment ($ billion)	2.1	11.9	3.5	2.3	16.9		–
Exports	1.1	-2.4	4.0	18.0	-2.0		–
Imports	1.4	3.8	3.0	11.8	13.0		–
Current account balance							
(nominal $ billion)	22.7	23.8	32.6	44.7	37.6		–
(percentage of GDP)	2.0	2.0	2.6	3.5	2.9		–
Nominal personal income	2.7	3.0	5.4	4.9	3.5		–
Nominal personal disposable income	3.8	3.0	5.5	5.0	2.0		–
Real personal disposable income	1.7	1.4	3.0	1.8	1.2		–
Profits before taxes	8.6	10.0	34.4	33.0	8.5		–
Costs and prices (%, y/y)							
GDP price deflator	1.0	3.2	1.7	3.6	3.9		–
Consumer price index	2.2	2.8	0.9	2.2	2.0	2.3	Oct-2004
CPI excluding eight most volatile items	2.4	2.2	1.3	1.7	1.7	1.4	Oct-2004
Unit labour costs	0.5	1.5	1.4	1.4	1.2		
Wage settlements (total)	2.8	2.5	2.8	1.3	1.3	1.5	Sep-2004
Labour market							
Unemployment rate (%)	7.7	7.6	7.4	7.2	7.1	7.3	Nov-2004
Employment growth	2.2	2.2	1.1	2.0	1.3	0.3	Nov-2004
Financial markets (average)							
Exchange rate (cents U.S.)	63.7	71.6	75.9	73.6	76.5	83.28	6-Dec-04
Prime interest rate (%)	4.2	4.7	4.2	3.8	3.8	4.25	6-Dec-04

Note: Real values are in chained 1997 dollars.
Sources: Statistics Canada, the Bank of Canada and Human Resources and Skills Development Canada.

Personal income registered a healthy 3.5% gain in the third quarter following a 4.9% increase in the second. Labour income growth eased as employment and compensation per employee both increased more modestly than in the second quarter. Real personal disposable income growth moderated for the third consecutive quarter, rising 1.2%, while real personal disposable income per capita inched up 0.1%. For the first time, consumers did not save out of their disposable income after saving only 0.5% of it in the second quarter.

Residential investment growth slows

Low interest rates continued to support housing activity. Residential investment increased 3.3% in the third quarter, down from 6.3% in the second and 9.0% in the first, the slowest growth rate since the second quarter of 2003. A slight increase in housing starts in the quarter supported modestly higher growth in new construction activity of 4.7% after a second-quarter gain of 3.9%. Renovations rose 12.3% following growth of 2.1% in the second quarter. House resales, however, fell in the third quarter, dropping

real estate transfer costs 15.6% from their second-quarter level and moderating growth in residential investment.

Business fixed investment strengthens

Business spending on plant and equipment grew 5.2% in the third quarter, the seventh consecutive increase. Investment in machinery and equipment increased 8.2%, up from the second-quarter pace (Chart 2). Spending soared on industrial machinery and information and communications technology equipment, especially computers and software, but dropped on non-automotive transportation equipment.

Non-residential construction inched higher for the second consecutive quarter, rising 0.6% after a gain of 0.9% in the second quarter. Increased spending on engineering projects was largely offset by reduced expenditures on building construction, such as office towers and shopping malls.

Business inventories build up

Businesses increased inventories by $16.9 billion in the third quarter following an inventory investment of $2.3 billion in the second quarter. The buildup was widespread across manufacturers, retailers and wholesalers, with much of it related to weak sales and exports of motor vehicles and increased production and imports. Nonetheless, the inventory-to-sales ratio remained near historical lows.

Exports fall

Following an 18.0% surge in the second quarter, real exports dipped 2.0% in the third as international demand weakened, with notable drops in energy and automotive products. Exports of forestry products and machinery and equipment showed modest and no growth respectively following huge gains in both categories in the second quarter. Exports of services declined as exports of commercial services dropped 10.2%, a fifth consecutive quarterly decline.

Imports jump

Real imports jumped 13.0%. Imports grew strongly in all major categories, except energy and agricultural and fishing products. Imports of automotive products jumped 33.5%, the strongest increase since the second quarter of 2001. Reflecting strong investment growth, machinery and equipment imports increased 17.0%, the third consecutive double-digit gain.

Current account surplus narrows

In the third quarter, the current account registered its 21st consecutive surplus, in contrast with deficits throughout most of the 1980s and 1990s. The surplus, however, fell to $37.6 billion, or 2.9% of nominal GDP, from $44.7 billion in the previous quarter (Chart 3). The goods trade surplus dropped $7.2 billion as higher export prices and lower

Chart 2
Growth in real machinery and equipment investment

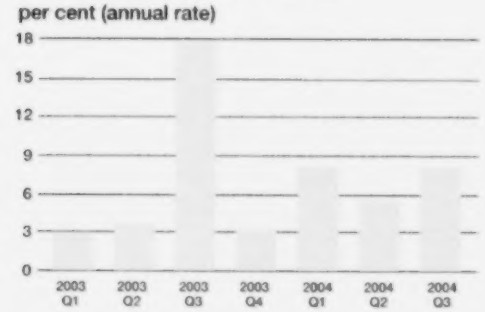
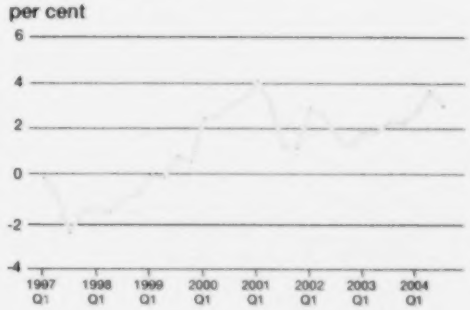


Chart 3
Current account as a percentage of nominal GDP

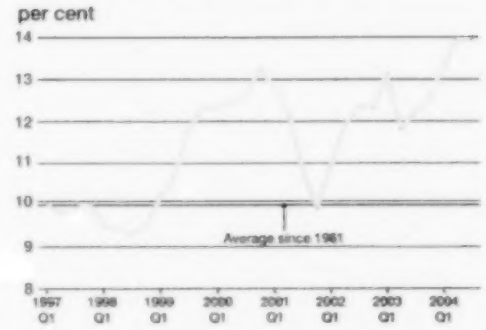


import prices moderated the negative impact of real trade movements. A deterioration in the investment income balance also contributed to the weaker current account, as dividends and retained earnings from direct investment abroad shrank more than dividends and retained earnings paid to non-residents.

Corporate profits continue to grow

Corporate profits rose 8.5% in the third quarter following four consecutive double-digit gains. Corporate profits as a share of GDP remained at 13.9%, well above the 10.1% historical average (Chart 4). Mining and oil and gas industries' profits rose with higher prices for their products. Manufacturers' profits, however, were restrained by weak exports.

Chart 4
Profits before taxes as a share of nominal GDP



Consumer price inflation remains low

The increase in the GDP deflator, a comprehensive measure of domestic prices, slowed to 3.7% in the third quarter from a 5.9% rise in the second to stand 3.9% higher than a year earlier.

Year-over-year consumer price inflation stood at 2.3% in October, up from 1.8% in September as food and energy prices rose. However, at 1.4% in October, core CPI inflation, which excludes the eight most volatile items, sat below the 2% mid-point of the 1% to 3% target band.

Employment grows

Employment grew 1.3% in the third quarter. In the first 11 months of 2004 the Canadian economy created nearly 195,000 net new jobs. The participation rate sat at 67.5% in November, up from October but still below its record high of 67.7% set in December 2003. The unemployment rate increased to 7.3% in November from 7.1% in September and October, when it hit its lowest level since mid-2001.

Hourly labour productivity dropped 4.6% in the third quarter, as strong growth in hours worked surpassed the gain in output. Labour costs per unit of output rose 0.4% to stand 1.2% higher than a year earlier.

Bank of Canada holds policy rate steady

The Canadian dollar climbed to its highest value in nearly 13 years, closing at 85.04 cents U.S. on November 26 before easing back to 83.28 cents U.S. on December 6. On December 7, the Bank of Canada maintained its key policy rate—the target for the overnight rate—at 2.50 per cent. This followed 25-basis-point increases in both September and October. The Bank stated that "if exchange rates were to persist at current levels, and if all other economic and financial factors were to remain unchanged, there would be a dampening effect on aggregate demand."

With the U.S. Federal Reserve having raised its target rate 25 basis points in each of August, September and November, the gap between Canadian and U.S. short-term interest rates has narrowed to under 30 basis points from over 80 basis points in October.

The main source of data used in this publication is Statistics Canada. Subscription inquiries should be directed to the Distribution Centre at (613) 995-2855. For other inquiries about this publication, contact Steven James at (613) 992-4321. Also available on the Internet at www.fin.gc.ca
Ce document est également offert en français.